LEC Contractors (M) Sdn Bhd (formerly known as Lotteworld Engineering & Construction Sdn Bhd) v Castle Inn Sdn Bhd & Anor

COURT OF APPEAL (KUALA LUMPUR) — CIVIL APPEAL NO W-02-789 OF 1998
LAMIN PCA, AHMAD FAIRUZ AND MOKHTAR SIDIN JJCA
29 MAY 2000

Contract *— Guarantee — Performance bond — Demand on — Performance bond executed pursuant to construction contract — Whether 'principal's written demand' includes demand by principal's solicitors — No proof of fraud — Bad faith and unconscionable conduct do not amount to fraud — Whether beneficiary needs to prove default in performance of contract — Whether balance of convenience test apply*

The plaintiff and the first defendant executed a contract for the construction and completion of a hotel cum office development. One of the terms and conditions of the contract was the depositing of a performance bond of RM4.8m. The plaintiff gave a bank guarantee issued by the second defendant. Disputes arose between the plaintiff and the first defendant as a result of which the plaintiff demanded arbitration proceedings. At the same time, the plaintiff took out a writ for a declaratory order and made an application for an injunction to restrain the first defendant from demanding the RM4.8m from the second defendant under the performance bond. The trial judge dismissed the plaintiff's application for injunction. The plaintiff appealed. The issues raised by the plaintiff were: (i) the notice of demand was invalid as it was not made by the first defendant but by its solicitors. Since the guarantee stated 'on the Principal's written demand' it was submitted that the demand must be made by the first defendant itself; (ii) the performance bond was a conditional bond. Therefore no lawful demand could be made until there was a breach or failure to execute the contract on the part of the plaintiff; (iii) the first defendant was guilty of fraud/unconscionable conduct; (iv) injunction should be granted because there were serious issues to be determined at an arbitration or in court; and (v) the status quo ought to be maintained to preserve the subject matter and substratum of the suit pending the disposal of the suit in respect of the underlying contract either through trial or arbitration.

Held, dismissing the appeal:

(1) The only mandatory part in the guarantee was on the guarantor to pay when the demand was made. There was no merit in the submission of the plaintiff that the demand must be made by the first defendant itself. There was a proper notice of demand in accordance with the guarantee (see p 350D, F).

(2) The bank guarantee in the present appeal was a performance bond. From the wordings of the guarantee, it was clear that it was 'on demand' performance bond and all that was required to

trigger them was a demand in writing. The guarantor will become liable merely when demand is made upon by the beneficiary with no necessity for the beneficiary to prove any default by the principal in performance of the principal contract (see pp 358F–359A); *Teknik Cekap Sdn Bhd v Public Bank Bhd* [1995] 3 MLJ 449 distinguished. A

(3) A proper demand had been made and as such the bank (second defendant) was obliged to pay the first defendant the amount stated in the bond. As to whether the plaintiff or the first defendant was at fault was not the concern of the bank. That dispute was for the parties to the contract to settle either by arbitration or by litigation in court. The bank had no choice but to pay the amount demanded. The first defendant was entitled to that sum not under the contract but under the performance bond (see p 359C–D). B C

(4) In order to justify any injunction to stop payment, there must be clear evidence of fraud on the part of the first defendant which came to the knowledge of the second defendant. Bad faith or unconscionable conduct by itself is not fraud. In the present appeal, not only fraud was not specifically pleaded but also the instances of fraud that the plaintiff had stated in his submission were not instances of fraud but disputes between the parties. Those disputes must be settled between the parties and they would not affect the performance bond. The court found that there was no evidence of fraud. What was more important was that the bank (second defendant) had no knowledge of any fraud or that fraud was ever given to their notice. As such the second defendant had no alternative but to honour the performance bond (see p 361D–H). D E F

(5) Since on demand performance bond is on similar footing as a letter of credit, serious issues to be tried is not one of the grounds upon which the court can grant an injunction against the beneficiary to stop payment from a bank under a performance bond. For that reason, there was no merit in the plaintiff's submission (see p 362F–G). G

(6) Based on authority, the balance of convenience test propounded in the *American Cynamid* case was not applicable to an irrevocable letter of credit. Since an on demand performance bond is of the same status as irrevocable letters of credit, the test was not applicable in the present appeal (see p 363A–B). H

(7) After considering the appeal as a whole, the court found that the trial judge came to the right conclusion when he refused the injunction. The court could not find any error in his decision. The granting of the injunction is a matter of discretion by the judge. The plaintiff had not shown that the judge had exercised his discretion wrongly or that the discretion exercised was illegal (see p 363E–G). I

A **[Bahasa Malaysia summary**

Plaintif dan defendan telah menyempurnakan suatu kontrak untuk pembinaan dan penyiapan sebuah pembangunan hotel bersama pejabat. Salah satu terma dan syarat-syarat kontrak tersebut adalah mendepositkan bon perlaksanaan sebanyak RM4.8 juta. Plaintif telah B memberikan gerenti bank yang dikeluarkan oleh defendan kedua. Pertikaian berbangkit antara plaintif dan defendan pertama yang mengakibatkan plaintif menuntut prosiding timbangtara. Pada masa yang sama, plaintif telah mengeluarkan writ untuk mendapatkan perintah deklarasi dan membuat satu permohonan untuk injunksi bagi menghalang defendan pertama daripada menuntut RM4.8 juta C tersebut daripada defendan kedua di bawah bon perlaksanaan tersebut. Hakim perbicaraan telah menolak permohonan plaintif untuk injunksi. Plaintif telah merayu. Isu-isu yang dibangkitkan oleh plaintif adalah: (i) notis tuntutan tersebut tidak sah kerana ia telah tidak dibuat oleh defendan pertama tetapi oleh peguamcaranya. Oleh kerana gerenti tersebut menyatakan 'on the Principal's written D demand' ('atas tuntutan bertulis Pihak Prinsipal') ia dihujahkan bahawa tuntutan itu mestilah dibuat oleh defendan pertama sendiri; (ii) bon perlaksaan itu merupakan satu bon bersyarat. Oleh itu tiada tuntutan yang sah di sisi undang boleh dibuat sehingga berlakunya satu kemungkiran atau kegagalan untuk E menyempurnakan kontrak tersebut oleh pihak plaintif; (iii) defendan pertama bersalah atas perbuatan fraud/perlakuan yang tidak berpatutan; (iv) injunksi seharusnya diberikan kerana terdapatnya isu-isu yang serius untuk ditentukan di prosiding timbangtara atau dalam mahkamah; dan (v) status quo seharusnya dipertahankan bagi mengekalkan hal-perkara dan substratum guaman tersebut F sementara menantikan penyelesaian guaman tersebut berhubung dengan kontrak yang menjadi asas sama ada melalui perbicaraan atau timbangtara.

Diputuskan, menolak rayuan tersebut:

G (1) Satu-satunya perkara mandatori dalam gerenti tersebut adalah di atas penggerenti supaya membayar apabila tuntutan dibuat. Tidak terdapat sebarang merit dalam penghujahan plaintif bahawa tuntutan itu semestinya dibuat oleh defendan pertama sendiri. Terdapat notis tuntutan yang sempurna mengikut kehendak gerenti tersebut (lihat ms 350D, F).

H (2) Gerenti bank dalam rayuan semasa ini merupakan satu bon perlaksanaan. Daripada perkataan-perkataan gerenti tersebut, adalah jelas bahawa ia merupakan bon perlaksanaan 'on demand' ('atas tuntutan') dan apa yang diperlukan untuk 'menggerakkannya' ialah satu tuntutan bertulis. Penggerenti I tersebut akan hanya menjadi bertanggungan apabila tuntutan dibuat oleh benefisiari tanpa perlu membuktikan sebarang kemungkiran oleh pihak prinsipal dalam melaksanakan kontrak

utama tersebut (lihat ms 358F–359A); *Teknik Cekap Sdn Bhd v Public Bank* [1995] 3 MLJ 449 dibeza. A

(3) Satu tuntutan yang sempurna telah dibuat dan oleh yang demikian bank tersebut (defendan kedua) berkewajipan untuk membayar defendan pertama jumlah yang dinyatakan di dalam bon tersebut. Berhubung dengan sama ada plaintif atau B defendan pertama telah melakukan kesilapan bukannya menjadi hal bagi bank tersebut. Pertikaian itu adalah terletak pada pihak-pihak kepada kontrak itu untuk menyelesaikannya sama ada melalui timbangtara atau melalui litigasi dalam mahkamah. Bank tiada pilihan melainkan membayar jumlah yang dituntut. Defendan pertama berhak kepada jumlah itu bukan di C bawah kontrak tersebut tetapi di bawah bon perlaksanaan (lihat ms 359C–D).

(4) Bagi mewajarkan sebarang injunksi untuk menghentikan pembayaran, haruslah terdapat keterangan yang jelas di pihak defendan pertama yang diketahui oleh defendan kedua. Niat jahat D atau perlakuan yang tidak berpatutan oleh dirinya sendiri bukannya perbuatan fraud. Dalam rayuan semasa ini, bukan sahaja fraud telah tidak diplidkan secara khususnya tetapi peristiwa-peristiwa fraud yang plaintif telah nyatakan dalam hujahan beliau bukannya merupakan peristiwa-peristiwa fraud tetapi adalah pertikaian antara pihak-pihak tersebut. Pertikaian- E pertikaian ini mestilah diselesaikan antara pihak-pihak tersebut dan ia tidak akan menjejaskan bon perlaksanaan tersebut. Mahkamah mendapati bahawa tidak terdapat keterangan fraud. Apa yang lebih penting adalah bahawa bank tersebut (defendan kedua) tiada pengetahuan mengenai sebarang fraud atau bahawa fraud pernah di bawah ke perhatian mereka. Oleh yang demikian, F defendan kedua tiada alternatif melainkan membayar bon perlaksanaan tersebut (lihat ms 361D–H).

(5) Oleh kerana bon perlaksanaan atas tuntutan adalah sama seperti surat kredit, isu-isu yang serius untuk dibicarakan bukannya salah satu alasan-alasan di atas yang mana mahkamah boleh G memberikan injunksi terhadap benefisiari tersebut untuk menghentikan pembayaran daripada sebuah bank di bawah sesuatu bon perlaksanaan. Atas alasan itu, tidak terdapat sebarang merit di dalam penghujahan plaintif (lihat ms 362F–G).

(6) Berdasarkan atas autoriti, ujian imbangan keselesaan yang H dikemukakan dalam kes *American Cynamid* tidak boleh dipakai kepada surat kredit yang tidak boleh batal. Oleh kerana bon perlaksanaan atas tuntutan mempunyai status yang sama seperti surat-surat kredit tidak boleh batal, ujian itu tidak boleh dipakai dalam kes semasa (lihat ms 363A–B).

(7) Setelah menimbangkan rayuan tersebut secara keseluruhannya, I mahkamah mendapati bahawa hakim perbicaraan mencapai keputusan yang betul apabila beliau menolak injunksi tersebut.

Mahkamah tidak dapat mengesan sebarang kesilapan di dalam keputusan beliau. Pemberian injunksi tersebut merupakan satu perkara budi bicara oleh hakim. Plaintif telah tidak menunjukkan bahawa hakim telah melaksanakan budi bicaranya secara salah atau bahawa budi bicara yang dilaksanakan adalah tidak sah di sisi undang-undang (lihat ms 363E–G).]

Notes

For cases on performance bond, see 3 *Mallal's Digest* (4th Ed, 1997 Reissue) paras 2353–2357.

Cases referred to

Bocotra Construction Pte Ltd v Attorney General (No 2) [1995] 2 SLR 733 (refd)

China Airlines Ltd v Maltran Air Corp Sdn Bhd (formerly known as Maltran Air Services Corp Sdn Bhd) and another appeal [1996] 2 MLJ 517 (refd)

D & C Finance Bhd v Che Mohamad bin Che Kob & Ors (High Court, unreported) (refd)

Deutsche Ruckversicherung AG v Walbrook Insurance Co Ltd & Ors [1995] 1 WLR 1017 (refd)

Edward Owen Engineering Ltd v Barclays Bank International Ltd & Anor [1978] 1 QB 159 (refd)

Esal (Commodities) Ltd & Anor v Oriental Credit Ltd & Anor [1985] 2 Lloyd's Rep 546 (refd)

Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd [1995] 1 MLJ 149 (refd)

Howe Richardson Scale Co Ltd v Polimex-Cekop and National Westminster Bank Ltd [1978] 1 Lloyd's LR 161 (refd)

Kejuruteraan Awam Cang Ceng (M) Sdn Bhd v The Standard Chartered Bank [1991] 3 CLJ 2502 (refd)

Lee Ah Chor v Southern Bank [1991] 1 MLJ 428 (refd)

Mok Hin Wah & Ors v United Malayan Banking Corp Bhd [1987] 2 MLJ 610 (refd)

Orang Kaya Menteri Paduka Wan Ahmad Isa Shukri bin Wan Rashid v Kwong Yik Bank Bhd [1989] 3 MLJ 155 (refd)

Sri Palmar Development & Construction Sdn Bhd v Transmetric Sdn Bhd [1994] 1 CLJ 224 (refd)

Syarikat Perumahan Pegawal Kerajaan Sdn Bhd v Bank Bumiputra Malaysia Bhd [1991] 2 MLJ 565 (refd)

Teknik Cekap Sdn Bhd v Public Bank Bhd [1995] 3 MLJ 449 (distd)

Appeal from: Suit No D6–22–2540 of 1998 (High Court, Kuala Lumpur)

Manjit Singh (*Lye Wing Voi* and *Yap Hsu-Lyn* with him) (*Vincent Lim & Teoh*) for the appellant.

VK Lingam (*R Sivagnanam* with him) (*VK Lingam & Co*) for the first respondent.

Eric Clement (*V Danaraj* with him) (*Siva Thurai Mariany & Co*) for the second respondent. A

Mokhtar Sidin JCA (delivering judgment of the court): We have dismissed the appeal earlier and now we give our reasons for doing so. To start with it is better for us to state the facts and the events leading to this appeal. B

On 24 July 1998, the appellant who was the plaintiff in the court below, took out a writ for a declaratory order. To avoid any confusion we will refer to the appellant and the respondents as the plaintiff and defendants as in the court below. The declaratory order sought by the plaintiff are:

(i) that the performance bond dated 22 August 1998 was supplemental to a contract dated 15 July 1995, and thus invalid; C

(ii) that the said contract and/or the performance bond did not permit the first defendant, whether by itself and/or through its agents or servants to make a call on the performance bond;

(iii) that an injunction be granted against the first defendant, whether by itself, or through its agents or servants from further calling and/or receiving the payment in the sum of RM4.8m which was payable upon the principal's written demand, made on the second-named defendant, until the disposal of the arbitration; D

(iv) for a declaration that the said performance bond is a conditional bond and that the second defendant is obliged to pay to the first-named defendant upon proof that the plaintiff is in breach of the obligations under the said contract, and that the plaintiff is not relieved from the performance of the contract; E

(v) the second-named defendant whether by itself or by its servants or agents be injuncted and restrained from paying the said sum of RM4.8m or any other sum that shall be payable under the performance bond until the disposal of the arbitration proceedings; and F

(vi) such other order/direction or relief.

At the same time the plaintiff took out an ex-parte summons in chambers praying for an order that: G

(i) an injunction be granted against the first-named defendant whether by itself, or by its servants or agents from further calling and/or receiving payments in the sum of RM4.8m under the performance bond from the second-named defendant, until the disposal of this matter inter-partes; and H

(ii) an injunction against the second-named defendant, restraining them from paying the first-named defendant, the sum of RM4.8m or any sum payable under the performance bond until the disposal of the hearing inter-partes. I

The undisputed facts leading to the filing of the writ and the summons in chambers were that on 15 July 1995 the plaintiff and the first defendant

executed a formal contract for the construction and completion of a hotel cum office development in Johor Bahru for the sum of RM96m. From the evidence it is clear to us that the plaintiff was awarded the contract by the first defendant by a letter dated 30 June 1995 whereby the plaintiff was required to execute a formal contract which was the contract dated 15 July 1995. One of the terms and conditions stipulated in the letter dated 30 June 1995 was the depositing of a performance bond of RM4.8m which is the subject matter of this appeal. Plaintiff apparently accepted this term when it signed the acceptance letter dated 30 June 1995. Since this letter is important it is better for us to state the contents of that letter:

> The Execution and Completion of the Proposed Hotel cum Office Development at Jalan Harimau Johor Bahru Johor For Castle Inn Sdn Bhd
> Letter of Acceptance of Tender
>
> 1.0 You are hereby informed that your tender for the above-mentioned works in the revised sum of Ringgit Malaysia: Ninety-Six Million Only (RM96m) is accepted subject to the terms, conditions and stipulations of the Tender Documents upon which the Tender is based and of this Letter of Acceptance. This revised tendered sum shall be deemed to include all revisions of works as shown in the list of revised drawings appended herewith (Page DL/1-DL/12) which shall form part of the Contract.
>
> 2.0 You will be required to execute in due course a formal Contract Agreement. However, until the formal Contract Agreement is executed, your Tender together with this Letter of Acceptance shall constitute a binding contract between yourselves and Castle Inn Sdn Bhd, hereinafter referred to as the Employer.
>
> 3.0 You will be informed when the Contract Documents are ready for your signature. However, before the signing of the Contract Documents, the prices and rates in the Tender Documents shall be scrutinised and adjusted by the Quantity Surveyor as to their reasonableness but the Contract Sum as mentioned above shall remain unaltered.
>
> 4.0 We wish to draw your attention to the stipulations of the Tender Documents whereby as conditions precedent to the commencement of the works, you are required to deposit with the Employer or the Architect the following:
>
> 4.1 Performance Bond amounting to RM4.8m (being 5% of the Contract Sum) in cash or in the form of an approved Banker's Guarantee.
>
> 4.2 Insurance Policy for Public Liability (ie insurance against injury to persons and damage to property) of an insured value not less than RM2,000,000.
>
> 4.3 Registration numbers under Employer's Social Security (SOCSO) scheme and/or
>
> 4.4 Insurance Policy for Workmen's Compensation for a value equivalent to 15% of the Contractor's work (being estimated total earning of Contractor's workmen not covered under SOCSO scheme).
>
> 4.5 Insurance Policy for the Insurance of the Works against Fire, etc as stipulated in the Tender Document.

Provided that for the purpose of commencement of the works and no other, you may produce to the Architect the Original Cover Notes of the abovementioned insurance policies and the receipts of premium paid. The Original Cover Notes are acceptable only for a valid interim period stipulated by the approved Insurance Company.

5.0 The date for Possession of Site as referred to in the Conditions of Contract shall be 15 July 1995 but no work under this Contract shall commence unless and until you have complied with the provisions of para 4 of this letter and you shall not be entitled to claim for any loss or damage caused by compliance to the requirement of this paragraph.

6.0 Based on the Tender Completion Period of Twenty Four (24) months, the Date of Completion for the whole of the Works under this Contract is 14 July 1997.

7.0 Further to the recent Tender Interviews, you have confirmed your agreement on the following:

7.1 You shall not be entitled to any advance payment.

7.2 To accept the specialist contractor, who has not been identified at this point of time, for the construction of the Sewerage Treatment Plant as your domestic sub-contractor and henceforth be fully responsible for their performance. You are however entitled to be paid for profit and attendance amounting to a total of 3% of the sub-contract price for Sewerage Plant Treatment.

8.0 You are to obtain approval in an acceptance form from the Department of Inland Revenue in respect to direct remittance of withholding tax. If you are unable to obtain such written approval then you are to identify and appoint an approved firm of solicitors or accountants to process these withholding tax payments to the appropriate authorities. All costs incurred in this appointment are to be borne by you.

9.0 This award is subject to the terms, conditions, stipulations and agreements in the following documents upon which this letter is based:

9.1 Tender Documents dated 16 May 1995.

9.2 Your letter of 30 May 1995 to Castle Inn Sdn Bhd subject to the following clarifications:

9.2.1 Item 2.3 of your letter: You shall use cast iron only for soil, waste and vent pipes at no extra cost or time to the contract.

9.3 Your letter of 7 June 1995 addressed to DBS Property Services Pte Ltd subject to the deletion of para 2.

9.4 Your letter of 14 June 1995 addressed to DBS Property Services Pte Ltd subject to the deletion of para 4.

9.5 This Letter of Award.

This contents of the above documents shall be deemed to be mutually complementary to this Letter of Award and this Letter of Award shall take precedence over any other document in the event of disputes as to the construction of the Contract. The Architect shall also decide between the discrepant items at no extra cost to the employer.

Six (6) copies of this letter are sent to you. Please return the original and four copies duly signed and witnessed where indicated to this office and retain one copy for your record. (Emphasis added.)

A The plaintiff acknowledged receipt of that letter and confirmed its agreement to the terms stated above. Pursuant to this letter the plaintiff then gave a Bank Guarantee No 0686/95/01925 issued by the second defendant. The contents of that bank guarantee which is the subject matter of this appeal are as follows:

B THIS AGREEMENT is made the 22 August 1995 BETWEEN The Bank of Nova Scotia Berhad of Menara Boustead, No 69, Jalan Raja Chulan, 50200 Kuala Lumpur (hereinafter called the 'Guarantor') of the one part and Castle Inn Sdn Bhd of Suite 138, First floor, Johor Tower, Jalan Gereja, 80100 Johor Bahru (hereinafter called the 'Principal') of the other part.

WHEREAS

C (1) This Agreement is supplemental to a Contract No ..... (hereinafter called 'the Contract') dated the 15 July 1995 and made between Lotteworld Engineering And Construction Sdn Bhd of Suite 11.2B, Level 11, Menara Pelangi, No 2, Jalan Kuning, Taman Pelangi, 80400 Johor Bahru, Johor (hereinafter called the 'Contractor') of the one part and the Principal of the other part whereby the Contractor agreed and

D undertake the EXECUTION AND COMPLETION OF THE PROPOSED HOTEL CUM OFFICE DEVELOPMENT AT JALAN HARIMAU, JOHOR BAHRU, JOHOR FOR CASTLE INN SDN BHD for the sum of Ringgit Malaysia: Ninety Six Million only (RM96m).

E (2) The Guarantor has agreed to guarantee the due performance of the said contract in the manner hereinafter appearing:

NOW the Guarantor hereby agrees with the Principal as follows:

(1) If the Contractor (unless relieved from the performance by any clause of the Contract or by statute or by the decision of a tribunal of competent jurisdiction) shall in any respect fail to execute the Contract or commit any breach of his obligations thereunder then

F *the Guarantor shall Pay to the Principal up to and not exceeding the sum of Ringgit Malaysia: Four Million Eight Hundred Thousand Only (RM4.8m) representing 5% of the Contract value or such Part thereof, on the Principal's written demand notwithstanding any contestation or Protest by the Contractor or by Guarantor or by any other third Party.*

G Provided always that the total of all partial written demands so made shall not exceed the sum of Ringgit Malaysia: Four Million Eight Hundred Thousand Only (RM4.8m) and that the Guarantor's liability to pay the Principal as aforesaid shall correspondingly be reduced proportionate to any partial demand having been made and paid as aforesaid.

H (2) The Guarantor shall not be discharged or released from this Guarantee by any arrangement between the Contractor and the Principal with or without the consent of the Guarantor or by any alteration in the obligations undertaken by the Contractor or by any forbearance whether as to payment, time, performance or otherwise, but the Guarantor shall be entitled to be informed of such arrangement or alteration.

I (3) *This Guarantee shall be irrevocable and shall remain in force and effect until the expiry of the Defects Liability Period for the whole of the Works Plus six (6) months ie 14 January 1999 or any authorised extension*

thereof, and in the case of the contract being determined, one calendar year after the date of the determination. Claims, if any, must be received by the Guarantor within the Period of the Guarantee ie on or before 14 January 1999. (Emphasis added.)

Apparently disputes arose between the plaintiff and the first defendant. As a result of those disputes, the plaintiff demanded arbitration proceedings by giving notice to the first defendant to arbitrate under cl 34(1) of the contract. At the same time the plaintiff took out the writ stated above. The plaintiff also took out the ex-parte summons in chambers to stop the first defendant from calling or receiving the sum of RM4.8m from the second defendant under the guarantee ('the performance bond'). This application was based on a certificate of urgency and was heard by the learned judge on 24 July 1998 whereby the learned judge granted the plaintiff a restraining order restraining the first defendant from further calling and/or receiving the sum of RM4.8m. The learned judge did not grant the injunction as prayed for by the plaintiff. The plaintiff then applied for the application to be heard inter-partes in order to obtain the injunction against the first defendant pending the disposal of the writ or the arbitration. As can be seen from the record it is the plaintiff who have moved the court to hear the disputes between the parties and to injunct the first defendant from demanding the RM4.8m from the second defendant under the performance bond.

At the end of the hearing of the application the learned judge dismissed the plaintiff's application for injunction and also set aside the restraining order given at the ex-parte hearing on 24 July 1998. The learned judge also gave interest at the rate of 8% pa on the sum of RM4.8m from 18 July 1998 in lieu of damages under the plaintiff's undertaking during the ex-parte hearing. 18 July 1998 was the date of demand made by the first defendant in its letter of demand to the second defendant. The learned judge awarded the interest on the ground that the first defendant had been deprived of the use of the money from that date.

Against that decision the plaintiff appealed to us.

Before us we identified that the plaintiff had raised five issues.

First Issue: Whether the notice of demand dated 18 July 1998 was a valid notice

This notice of demand is exhibited at p 663 of the record of appeal (vol 3). Since this is a short letter it is better for us to quote it in full:

LCF/AC/tyh/195/97P

18 July 1998

The Bank of Nova Scotia Bhd
Menara Boustead
No 69, Jalan Raja Chulan
PO Box 11056
50734 Kuala Lumpur.

BY HAND

Dear Sirs,

Contract dated 15 July 1995 between Castle Inn Sdn Bhd and Lotteworld Engineering & Construction Sdn Bhd for the execution and completion of the

A *proposed Hotel Cum Office Development at Jalan Harimau, Johor Bahru, Johor (hereinafter referred to as 'the Contract')*
Bank Guarantee No 0686/95/01925 for the amount of RM4.8m (hereinafter referred to as 'the Performance Bond')

We act for Messrs Castle Inn Sdn Bhd who is the beneficiary in respect of the above matter.

B We are instructed to inform you that Lotteworld Engineering & Construction Sdn Bhd is in breach of its obligations under the contract, inter alia, for failing to comply with the Architect's Notice of Default dated 26 June 1998 resulting in our client determining Lotteworld Engineering & Construction Sdn Bhd's employment under the contract. Please find enclosed the relevant letters.

C We hereby demand that the sum of RM4.8m under the performance bond be paid forthwith to our client or to us as its solicitors.

Yours faithfully,

Azman, Davidson & Co

D Sgd

It was submitted by the plaintiff that the demand was invalid as it was not made by the first defendant. The demand ought to have been made by the first defendant and not by its solicitors. It was submitted that the demand must be made strictly in accordance with the terms of the guarantee. In the E guarantee it is stated as follows:

> ... the Guarantor shall pay to the Principal up to and not exceeding the sum of Ringgit Malaysia: Four Million Eight Hundred Thousand Only (RM4.8m) representing 5% of the Contract value or such part thereof, on the Principal's written demand notwithstanding any contestation or protest by the Contractor or by Guarantor or by any other third party. ...

F Since the guarantee stated 'on the Principal's written demand' it was submitted that the demand must be made by the first defendant itself. In the present appeal notice of demand was made by the solicitors for the first defendant and as such the demand made was not valid. It was submitted that the demand must be made strictly in accordance with the terms of the G guarantee. To support this contention the plaintiff cited four cases: *Mok Hin Wah & Ors v United Malayan Banking Corp Bhd* [1987] 2 MLJ 610; *Orang Kaya Menteri Paduka Wan Ahmad Isa Shukri bin Wan Rashid v Kwong Yik Bank Bhd* [1989] 3 MLJ 155; *Lee Ah Chor v Southern Bank* [1991] 1 MLJ 428 and *D & C Finance Bhd v Che Mohamad bin Che Kob & Ors* (a High Court decision which was unreported).

H It is clear to us that the cases of *Mok Hin Wah* and *Orang Kaya Menteri Paduka Wan Ahmad Isa Shukri bin Wan Rashid* can easily be distinguished from the present appeal. In those cases the notice of demand sent to the guarantor was a carbon copy of the notice to the principal. As such it was held that the notice of demand as against the guarantor was not good. In the I case of *Lee Ah Chor* it is clear to us that it does not support the contention made by counsel for the plaintiff. It is clear to us that the notice of demand required in that case is somewhat similar to the provisions in the present

appeal. In that case as can be seen at p 432 the relevant provisions in respect of that case was cl 11 which reads as follows: A

> Any notice or demand in relation to the matters aforesaid *may be effectually given* or made to me/us by any officer of the bank or by notice in writing under the hand of any such officer either served personally on me/us or left for or sent by post to me/us at my/our usual or last known place of business in ... . B

Comparing this demand and the demand in the present case we find that the demand in *Lee Ah Chor* was more restrictive in the sense that the notice was to be made 'by any officer of the bank' whereas in the present case it was 'the principal's written demand'. In *Lee Ah Chor* the then Supreme Court held at p 432: C

> In the present case, as clearly provided by cl 11 of the first guarantee, the mode of serving the notice can either be made by an officer of the bank or by the solicitor as agent of the bank and therefore the service of the notice by the solicitor acting for the respondent is a valid notice.

In the present case the only mandatory part is on the guarantor to pay when the demand is made. As such we are of the view what was held in *Lee Ah Chor* is applicable here. D

As to the case of *D & C Finance Bhd v Che Mohamad bin Che Kob & Ors* the words 'By You' was used. That by itself distinguished it from the present appeal. That was a decision of the High Court. We are of the view that what was said there cannot be the correct proposition of law. As can be seen D & C Bank is only a legal entity not a real person. If the word 'By You' is to be interpreted strictly then it is impossible for the bank by itself to make a demand. The demand had to be made by the bank not by an officer or by any director. In our view the words 'By You' mean that the demand shall be made by the bank through its officers or legal representatives which falls back to the decision in *Lee Ah Chor*. E F

In view of what we have stated we are of the view that there is no merit in the submission of the plaintiff. We hold that there was a proper notice of demand in accordance with the guarantee.

G

Second issue: Whether the performance bond in the instant case is a conditional or unconditional bond

It was submitted by the plaintiff the performance bond was a conditional bond. Counsel for the plaintiff referred to the following clause in the guarantee: H

> (1) If the Contractor (unless relieved from the performance by any clause of the Contract or by statute ...) ... commit any breach of his obligations thereunder then the Guarantor shall pay to the Principal up to and not exceeding the sum of Ringgit Malaysia: Four Million Eight Hundred Thousand Only (RM4.8m) representing 5% of the Contract value or such part thereof, on the Principal's written demand notwithstanding any contestation or protest by the Contractor or by Guarantor or by any other third party I

The learned counsel for the plaintiff then cited the case of *Teknik Cekap Sdn Bhd v Public Bank Bhd* [1995] 3 MLJ 449. Learned counsel submitted that the performance bond in the present appeal is in pari materia with the performance bond in that case and the Court of Appeal in that case held that the performance bond to be a conditional bond. Since the performance bond in the present appeal is a conditional bond no lawful demand could be made until there is a breach or failure to execute the contract on the part of the plaintiff. The breach would be of any of the terms of the underlying contract. As such one has to examine the underlying contract and determine whether the plaintiff was in breach of any of its terms. Plaintiff went on to submit that the standard in *Teknik Cekap* is still too low. It was submitted by counsel for the plaintiff that the contractor must be adjudged by a competent tribunal of law to be in breach of contract and the breach ought to be identified and proved.

On the other hand, it was contended by learned counsel for the first defendant that the real issue is whether the bond is payable on demand, or whether the bond is only payable upon proof of breach of the underlying contract. The issue is not whether the bond is conditional or unconditional. We are of the same view with the learned counsel for the first defendant as can be seen in *Syarikat Perumahan Pegawal Kerajaan Sdn Bhd v Bank Bumiputra Malaysia Bhd* [1991] 2 MLJ 565. In that case the cause of action of the plaintiff was grounded on the alleged breach of a bank guarantee whereby the defendant agreed to guarantee the due performance of a building contract. The contract was entered between the plaintiff and Sarikon Sdn Bhd ('the contractor') whereby the contractor undertook to complete certain construction works. On 15 December 1987, the receivers and managers of the contractor informed the plaintiff by telex of their intention to terminate all works under the building contract with effect from 18 December 1987 and apparently on that date the contractor abandoned all works on site. The plaintiff called upon the defendant to honour the bank guarantee which the defendant failed to do. The defendant contended that since Sarikon had alleged that the plaintiff had wrongly terminated the contract, the plaintiff had no right to call upon the defendant to honour the guarantee. As such the defendant contended that the guarantee is a conditional performance bond and not an on demand performance bond. Lim Beng Choon J in his judgment at pp 567–568 said:

> A review of the English case law seems to suggest that a performance guarantee, like an irrevocable or confirmed letter of credit, is a guarantee by the bank to a seller for payment of price. The bank is not concerned with the contract entered into by its customer and the third party or with any dispute between the buyer and the seller. The terms of the guarantee and the bank's obligation to pay are contained in the guarantee itself. There is a line of English authorities acknowledging this proposition — see for example *Hamzeh Malas & Ors v British Imex Industries Ltd* [1958] 1 All ER 262, *Discount Records Ltd v Barclays Bank Ltd* [1975] 1 All ER 1071 and *RD Harbottle (Mercantile) Ltd v National Westminister Bank* [1977] 3 WLR 752. The principle laid down in these authorities has been considered by the English Court of Appeal in *Edward Owen Engineering Ltd v Barclays Bank* [1978] 1 QB 159. Thus Lord Denning said at p 171 of the reported case:

> 'All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice.'

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However that may be, the question to ask and to be answered is whether the English common law principle can apply to a performance guarantee given in our country in view of s 81 of our Contracts Act 1950. That section says:

> 'The liability of the surety is co-extensive with that of the principal debtor *unless it is otherwise provided by the contract.*' (Emphasis added.)

C

To my mind, the words emphasized by me are of some significance. The said words reduce the efficacy of the provision that the liability of the surety is co-extensive with that of the principal debtor in cases where a surety has executed an agreement of guarantee or indemnity with the person indemnified indicating that the surety would pay subject only to the terms of the said agreement. In this respect therefore the English common law rule of disregarding whether the surety's obligation is absolute or conditional cannot apply. Since our contract statute is a replica of the Indian Contract Act 1872, it is useful to look into the Indian authorities in order to find out how the Indian courts deal with the issue. The answer to the issue can be found in *United Commercial Bank v Bank of India* where it is stated at p 1438:

D

E

> 'A bank which gives a performance guarantee must honour that guarantee according to the terms. In *RD Harbottle (Mercantile) Ltd v National Westminster Bank* [1977] 3 WLR 752, Kerr J considered the position in principle. We would like to adopt a passage from his judgment at p 761: It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the lifeblood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration as available to them or stipulated in the contracts. The courts are not concerned with their difficulties to enforce such claims; these are risks which the merchants take. In this case the plaintiffs took the risk of the unconditional wording of the guarantees. The machinery and commitments of banks are on a different level. They must be allowed to be honoured, free from interference by the courts. Otherwise trust in international commerce could be irreparably damaged.'

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Again it was held in *Damatar Paints (P) Ltd v Indian Oil Corp* AIR 1982 Delhi 57 that an irrevocable performance bank guarantee is a distinct separate transaction. If disputes arise between the company on whose behalf the guarantee is given and a corporation in whose favour it is given and the disputes are referred to arbitration, the payment of the guarantee cannot be stayed pending the arbitration. This proposition is followed in *Pesticides India v State Chemicals & Pharmaceuticals Corp of India* AIR 1982 Delhi 78.

I

Adverting to the bank guarantee, its heading states 'Bank Guarantee for *the Performance Bond*' (emphasis added) and in recital (2) it is stated:

A The Guarantor has agreed to guarantee the due performance of the contract in the manner hereinafter appearing.

The crucial condition appears in para (1) of the said agreement which reads:

(1) If the contractor (unless relieved from the performance by any clause of the Contract or by statute or by decision of a tribunal of competent jurisdiction) shall in any respect fail to execute the Contract or commit B any breach of his' obligations thereunder then the Guarantor will indemnify and pay the principal the sum of Malaysian Ringgit: One hundred seventy-nine thousand three hundred eighty four and sen fifty eight only (RM179,384.58) provided that the principal or his authorized representative has made a claim against the Guarantor not later than six (6) months after the expiry date of the Contract.

C It can at once be noted that the defendant is bound to indemnify the plaintiff should Sarikon fail to execute the contract or commit any breach of their obligations thereunder unless relieved from the performance by any clause of the contract or by statute or by decision of a tribunal of competent jurisdiction. When Sarikon failed to execute the contract, that is, when they failed 'to complete and carry into effect' the works (see meaning of 'execute' D as defined in *Jowitts Dictionary of English Law* (2nd Ed) (Vol 1 p 741) and they were not excused by any term in the contract or by the decision of a tribunal made before the demand for indemnity by the plaintiff to the defendant under the terms of the bank guarantee, then the defendant is bound to pay on demand. ...

E As can be seen from the above the wordings of the guarantee in that case if not identical are similar to cll (1) and (3) of the guarantee in the present case. The guarantee in the present appeal is more elaborately worded but the meaning is the same. We entirely agreed with what had been said by Lim Beng Choon J in the above case. Haidar bin Mohd Noor J (as he then was) in the case of *Kejuruteraan Awam Cang Ceng (M) Sdn Bhd v The Standard* F *Chartered Bank* [1991] 3 CLJ 2502, and Mahadev Shankar J (as he then was) in the case of *Sri Palmar Development & Construction Sdn Bhd v Transmetric Sdn Bhd* [1994] 1 CLJ 224 were of the same view.

The then Supreme Court in *Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd* [1995] 1 MLJ 149 was of the same view. In that case the G appellant agreed with the respondent, for the respondent to sell and deliver certain construction materials to the appellant from time to time on specified dates which were regarded as being the essence. It was agreed between the parties that the appellant would be entitled to deduct a maximum of 10% of the purchase price in respect of any delay in delivery by the respondent. However, at the request of the respondent, the appellant H paid the full price in exchange of two letters of guarantee ('the performance bond') issued by Bank Bumiputra (M) Bhd ('the bank'), for the sum of RM466,562 and RM17,640 totalling RM484,202, which was equivalent to the deductions the appellant would have been entitled to make. Subsequently, the appellant informed the respondent that damages for delay amounted to 90% of the total sum of RM484,202 and requested for I payment within seven days. Payment was not made and the respondent wrote to the appellant for particulars justifying the claim. Without replying, the appellant made a written demand on the performance bonds addressed

to the bank. The respondent obtained an ex-parte injunction restraining the appellant from receiving any part of the moneys under the performance bonds and alleged that: (a) the delays were caused by Esso's refusal to accept the goods; and (b) the appellant had not, at the time of acceptance of the delayed goods, indicated its intention to claim damages. The appellant's application to the High Court to set aside the injunctions was dismissed. The appellant appealed against that decision. The then Supreme Court held that:

(1) The performance bonds were stated to be 'unconditional' guarantees and, on a true construction, were pure 'on demand' guarantees. All that was required to trigger them was a demand in writing.

(2) Since the performance bonds were on demand performance bonds, they were independent of any underlying contract between Esso and Kago. Therefore, it was not open to the judge to inquire into any breach of such underlying contract as he seemed to have done.

Peh Swee Chin FCJ (as he then was), delivering the judgment of the court at pp 156–157 said:

> That the real issue of a performance bond is one of contractual interpretation was the unanimous view of three judges in the Court of Appeal in *IE Contractors Ltd v Lloyds Bank plc and Rafidain Bank* [1990] 2 Lloyd's Rep 496; (1991) 51 BLR 1. It is not our intention to write an essay on performance bonds, in the instant appeal, except to repeat that it 'involves a straightforward exercise of construction, or interpretation, of the bond to discover the intention of the parties' — per Sir Denys Buckley in *IE Contractors* [1990] 2 Lloyd's Rep 496 at p 503; (1991) 51 BLR 1 at p 15 .
>
> Looking at the performance bond (Bank Guarantee No 065–92–106) as set out above, it was stated to be an 'unconditional' guarantee. The only other thing of note would be the stated requirement that all claims must be made in writing. This performance bond was, on a true construction, a pure on demand guarantee, and all that was required to trigger it was a demand in writing. It would not be dependent or conditional on the production of a document, eg a certificate from some nominated independent person like an architect as in some building contracts, etc. Neither was it worded to make it conditional for Bank Bumiputra, the issuer of the performance bond, to inquire into the existence or otherwise of any breach of any contractual obligation between the beneficiary of the bond, ie the buyer in this case, and the seller; at the behest of the latter itself, the performance bond was issued. It was not even worded to make it conditional on a simple declaration by the beneficiary, without proof to its issuer, that the seller had not paid damages to the buyer after the release by the buyer of the sum of RM466,562. In fact, the present performance bond, had it been worded, eg to require any proof of breach by the buyer so as to deserve any payment, then, in such event, its commercial acceptability as a performance bond, would be mostly lost.
>
> Dealing further with the construction of the performance bond, since we found it was an on demand performance bond, this would, in our view, make the present performance bonds independent of any underlying contract, ie any contract between the buyer and the seller. We thought, therefore, it was not open to his Lordship in the court below to impart into this on demand guarantee, by implication, a requirement to have regard to, or to inquire into any breach of any obligation of such underlying contract, and this seemed to

A have been done. The next and only other question from the instant performance bonds would be as to what sort of demand it would be as required by its wording.

The Federal Court in *China Airlines Ltd v Maltran Air Corp Sdn Bhd (formerly known as Maltran Air Services Corp Sdn Bhd) and another appeal* [1996] 2 MLJ 517 held that a bank guarantee is a performance bond of B which there are two types. The first is a conditional bond whereby the guarantor becomes liable upon proof of a breach of the terms of the principal and beneficiary sustaining loss as a result of such breach. The guarantor's liability will therefore be as a result of such breach. The second is an 'unconditional' or 'on demand' bond where the guarantor will become C liable when demand is made upon him by the beneficiary with no necessity to prove any default in performance of the principal contract. In that case the wordings of the letter of guarantee as at p 533 reads as follows:

Letter of Guarantee

D We Perwira Habib Bank Malaysia Bhd, Cawangan Bandar, Tingkat Bawah Wisma Pahlawan, Jalan Sulaiman, 50000 Kuala Lumpur, hereby undertake to pay on demand to Messrs China Airlines Ltd the sum of RM400,000 (Ringgit Malaysia: Four Hundred Thousand Only) as may be required for the due performance of the covenants in the contract between you and Messrs Maltran Air Corp Sdn Bhd, 79, 2nd Floor, Jalan Bukit Bintang, 55100 Kuala Lumpur. The said sum shall become payable by us in the event of the said E Messrs Maltran Air Corp Sdn Bhd's failure to perform the said covenants.

As can be seen the wordings are somewhat similar to the wordings in the present appeal. Mohamed Dzaiddin FCJ, delivering the judgment of the court in that case, at pp 534–535, said:

F A bank guarantee is a performance bond. There are two types of performance bond. The first type is a conditional bond whereby the guarantor becomes liable upon proof of a breach of the terms of the principal contract by the principal and the beneficiary sustaining loss as a result of such breach. The guarantor's liability will therefore arise as a result of the principal's default. The second type is an unconditional or 'on demand' performance bond which is so drafted that the guarantor will become liable merely when demand is G made upon him by the beneficiary with no necessity for the beneficiary to prove any default by the principal in performance of the principal contract. According to the learned authors of *The Modern Contract of Guarantee* (2nd Ed) at p 664, the tendency of the English courts (since, according to the authors, that the Australian courts have not yet been faced with the same problems of construction) has been to treat the performance bonds as H unconditional if there was a clear statement that the amount guaranteed was payable by the bank simply upon a written demand being made, even though there might be some indications to the contrary elsewhere in the document. The learned authors cited *Esal (Commodities) Ltd* as case, where the bank 'undertook to pay the said amount on your written demand *in the event that the supplier fails to execute the contract in perfect performance*' (emphasis added), it was held that the latter words did not alter the fact that the money was I payable upon a written demand being made as stated in the earlier part of the clause. The beneficiary of the bond did not have to show a failure to perform by the supplier in order to claim upon the bond.

From the authorities referred above the tendency of the Malaysian courts is to interpret the performance bonds in accordance with the decision of *Esal (Commodities) Ltd & Anor v Oriental Credit Ltd & Anor* [1985] 2 Lloyd's Rep 546. At p 549 Ackner LJ said:

> ... As Mr Sumption for WF correctly submitted, if the performance bond was so conditional, then unless there was clear evidence that the seller admitted that he was in breach of the contract of sale, payment could never safely be made by the bank except on a judgment of a competent court of jurisdiction and this result would be wholly inconsistent with the entire object of the transaction, namely to enable the beneficiary to obtain prompt and certain payment. There is no need to cite, at any length, the well-known case of *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 QB 159 as to the general nature of a performance bond, where it is stressed that a bank is not concerned in the least with the relations between the supplier and the customer nor with the question whether the supplier has performed his contractual obligation or not, nor with the question whether the supplier is in default or not, the only exception being where there is clear evidence both of fraud and of the bank's knowledge of that fraud. ...
>
> However, I accept Mr Tugendhat's alternative submission that in addition to the beneficiary making the demand, he must also inform the bank that he does so on the basis provided for in the performance bond itself. ...

Since the decision of *Edward Owen Engineering Ltd v Barclays Bank International Ltd & Anor* [1978] 1 QB 159 was referred to in the above decision it is better for us to look at it. In that case the plaintiffs contracted with Libyan customers to erect greenhouses in Libya and agreed with a performance guarantee for 10% of contract price should be issued by the defendant and lodged with a Libyan bank. The contract, which was governed by Libyan law, provided that an irrevocable confirmed, confirmable letter of credit payable at the defendant bank was to be opened in favour of the plaintiffs. After the plaintiffs had given a counter guarantee to the defendant bank, the latter on their own responsibility and on the plaintiffs' behalf gave a performance bond for £50,203 to the Libyan bank and confirmed that their guarantee was payable 'on demand without proof or conditions'. The Libyan bank then issued a guarantee bond for the plaintiffs for the same sum in favour of the Libyan customers. No letter of credit which complied with the terms of the contract was opened by the customers and the plaintiffs, after telling them that the guarantee given had no effect, accepted their conduct as a repudiation of the contract. At the customers' request the Libyan bank then claimed £50,203 under the guarantee from the defendant. The plaintiffs obtained an interim injunction on their ex-parte application to restrain the defendant from paying the Libyan bank. Kerr J discharged the injunction. The plaintiffs appealed. The Court of Appeal dismissed the appeal. Lord Denning MR at p 169 said:

> A performance bond is a new creature so far as we are concerned. It has many similarities to a letter of credit, with which of course we are very familiar. It has been long established that when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents are in order and the terms of the credit are satisfied. Any dispute between buyer and seller must be settled between themselves. The bank must honour the credit. That was clearly

A stated in *Hamzeh Malas & Sons v British Imex Industries Ltd* [1958] 2 QB 127 Jenkins LJ, giving the judgment of this court, said, at p 129:

> '... it seems to be plain enough that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether
B the goods are up to contract or not. An elaborate commercial system has been built up on the footing that bankers' confirmed credits are of that character, and, in my judgment, it would be wrong for this court in the present case to interfere with the established practice.'

To this general principle there is an exception in the case of what is called established or obvious fraud to the knowledge of the bank. The most
C illuminating case is of *Sztejn v J Henry Schroder Banking Corporation* (1941) 31 NYS 2d 631 which was heard in the New York Court of Appeals. After citing many cases Shientag J said, at p 633:

> 'It is well established that a letter of credit is independent of the primary contract of sale between the buyer and the seller. The issuing bank agrees to pay upon presentation of documents, not goods. This rule is necessary
D to preserve the efficiency of the letter of credit as an instrument for the financing of trade.'

He said, at p 634, that in that particular case it was different because:

> 'On the present motion, it must be assumed that the seller has intentionally failed to ship any goods ordered by the buyer. In such a
E situation, where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment, the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller.'

That case shows that there is this exception of the strict rule: the bank ought not to pay under the credit if it knows that the documents are forged or that
F the request for payment is made fraudulently in circumstances when there is no right to payment.

I would in this regard quote the words of Browne J in an unreported case when he was sitting at first instance. It is *Bank Russo-Iran v Gordon, Woodroffe & Co Ltd* (unreported), 3 October 1972. He said:

G
> 'In my judgment, if the documents are presented by the beneficiary himself, and are forged or fraudulent, the bank is entitled to refuse payments if it finds out before payment, and is entitled to recover the money as paid under a mistake of fact if it finds out after payment.'

But as Kerr J said in this present case:

H
> 'In cases of obvious fraud to the knowledge of the banks, the courts may prevent banks from fulfilling their obligation to third parties.'

Such is the law as to a confirmed letter of credit. How does it stand with regard to a performance bond or a performance guarantee? Seeing that it is a guarantee of performance — that is a guarantee that the supplier will perform his contracted obligations — one would expect that it would be enfored in
I such a case as this:

> 'So, as one takes instance after instance, these performance guarantees are virtually promissory notes payable on demand. So long as the Libyan

> customers make an honest demand, the banks are bound to pay: and the banks will rarely, if ever, be in a position to know whether the demand is honest or not. At any rate they will not be able to prove it to be dishonest. So they will have to pay.'

All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice.

Such has been the course of decision in all the cases there have been this year in our courts here in England. First of all, there was *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] QB 146 before Kerr J. The judge considered the position in principle. I would like to adopt a passage from his judgment, p 761E-G:

> 'It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration. ... The courts are not concerned with their difficulties to enforce such claims; these are risks which the merchants take. In this case the plaintiffs took the risk of the unconditional wording of the guarantees. The machinery and commitments of banks are on a different level. They must be allowed to be honoured, free from interference by the courts. Otherwise, trust in international commerce could be irreparably damaged.'

That is the position of an on demand performance bond. It is clear to us that the bank guarantee in the present appeal is a performance bond. From the wordings of the guarantee it is clear to us that it is 'on demand' performance bond and as stated in *Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd*: 'All that was required to trigger them was a demand in writing'; or in the words of Mohamed Dzaiddin FCJ in the case of *China Airlines Ltd v Maltran Air Corp Sdn Bhd*: '... the guarantor will become liable merely when demand is made upon by the beneficiary with no necessity for the beneficiary to prove any default by the principal in performance of the principal contract.

The appellant claimed that the bank guarantee is a conditional bond. To support this contention learned counsel for the appellant referred to the case of *Teknik Cekap*, a decision of this court where the court held that a performance bond was a conditional bond. It was held by the court that because the bond began with the words 'if the sub-contractor ... shall in any respect fail to execute the contract or commit any breach of his obligations thereunder then the guarantor shall pay ...'. Apparently this is the only case in Malaysia where similar wordings had been used where the court had held

that it was a conditional bond. In our view the court in the case of *Teknik Cekap* decided it on its own facts. Apparently one of the factors that influenced the court and the court below was the fact that the demand made was bad in law. This in our view distinguished that case from the present appeal.

From the authorities we have referred earlier it is clear to us that to determine whether a performance bond is a conditional or unconditional bond, the court should not be concerned whether there was actual breach being committed or not. It is for the parties to litigate as to whom the blame is to be placed. The court is only concerned whether on the wordings of the bond, it is an on demand bond. If it is so then the bank has to pay the person whom it guaranteed. The only exception to this is in the case of fraud which comes to the notice of the bank. As we have said earlier it is clear to us that this is an on demand performance bond. A proper demand had been made and as such the bank (second defendant) is obliged to pay the first defendant the amount stated in the bond. As to whether the plaintiff or the first defendant was at fault is not the concern of the bank. That dispute is for the parties to the contract to settle either by arbitration or by litigation in court. The bank has no choice but to pay the amount demanded. The first defendant is entitled to that sum not under the contract but under the performance bond.

Third Issue: Fraud

When a performance bond is found to be an on demand bond then no injunction could be obtained to stop the payment. There may be good grounds between the parties for injunction to apply but they would not be good to injunct the bank as can be seen in the case of *Edward Owen* where the injunction was set aside because the guarantee was an on demand performance bond. The only exception is in case of fraud which is brought to the notice of the bank. This is not the case here. As can be seen from the statement of claim it pleaded bare allegations of fraud. No specific instances of fraud had been given. Fraud must be specifically pleaded and proved. Mere allegation is not sufficient. This is clearly stated by Phillips J in *Deutsche Ruckversicherung AG v Walbrook Insurance Co Ltd & Ors* [1995] 1 WLR 1017. After referring the passages by Lord Denning in *Edward Owen* at p 1029, Phillips J said:

> In a number of instances the courts have purported to apply the Cyanamid-test [1975] AC 396 in a case such as this: *Howe Richardson Scale Co Ltd v Polimex-Cekop* [1978] 1 Lloyd's Rep 161 at p 165, per Roskill LJ, *Dong Jin Metal Co Ltd v Raymet Ltd* (unreported), 13 July 1993; Court of Appeal (Civil Division) Transcript No 945 of 1993, per Lloyd LJ and *United Trading Corporation SA v Allied Arab Bank Ltd* (Note) [1985] 2 Lloyd's Rep 554. Only in this last case did the court consider the nature of the threshold test. This raised the question of the cause of action where an injunction is sought to prevent a bank paying under a performance bond. Both parties agreed, having regard to *Siskina (Owners of cargo lately laden on board) v Distos Compania Naviera SA* [1979] AC 210, that a cause of action had to be demonstrated. Negligence was selected as the most plausible cause of action. Ackner LJ

[1985] 2 Lloyd's Rep 554 at p 561 held that 'the evidence of fraud must be clear, both as to the fact of fraud and as to the bank's knowledge' and went on to define the Cyanamid threshold test as follows:

> 'Have the plaintiffs established that it is seriously arguable that, on the material available, the only realistic inference is that [the beneficiaries] could not honestly have believed in the validity of its demands on the performance bonds?'

The nature of the cause of action in a case such as this has not often been considered by the courts. Ackner LJ remarked that in America, which is the source of the fraud exception, it is not necessary for a plaintiff to demonstrate a cause of action against a bank: see [1985] Lloyd's Rep 554 at p 561. In *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168 at p 184 Lord Diplock stated:

> 'The exception for fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim ex turpi causa non oritur actio or, if plain English is to be preferred, 'fraud unravels all'. The courts will not allow their process to be used by a dishonest person to carry out a fraud.'

This raises a question of whether, as an exception to the *Siskina* principle [1979] AC 210, the court will intervene by injunction to prevent the perpetration of a fraud. In *Bolivinter Oil SA v Chase Manhattan Bank NA* (Practice Note) [1984] 1 Lloyd's Rep 251 at p 254, Sir John Donaldson MR accepted the following proposition:

> 'The court should grant an injunction restraining payment under a letter of credit or performance guarantee where the result of payment is likely to be to permit the ultimate beneficiary to profit from his own fraud at the expense of the plaintiff. ... The basis of the jurisdiction is not the power of the court to grant an injunction restraining a breach of contract. The plaintiff does not have to establish that the payment enjoined would constitute a breach of contractual duty owed to the plaintiff by the bank. The basis of the jurisdiction is wider — the power of the court to intervene where necessary to prevent fraud. The plaintiff has to show that his legal rights are threatened by the fraud of the beneficiary.' ...

I turn to consider Mr Bartlett's submission that a different test fails to be applied where an injunction is sought against the beneficiary. It seems to me that the effect of Mr Bartlett's submissions is to deprive the letter of credit of any special status so far as the beneficiary is concerned. If a beneficiary is to be held to be fraudulent if he draws on a letter of credit in circumstances where he is uncertain as to the validity of his right to payment under the underlying contract, the plaintiff seeking to enjoin him will have to do more than persuade the court that there is a seriously arguable case that the claim under the underlying contract is invalid. This will rob the beneficiary of much of the benefit which a letter of credit is intended to bestow. Where a letter of credit is issued by way of conditional payment under an underlying contract, I do not consider that it is correct to imply a term into the underlying contract that the beneficiary will not draw on the letter of credit unless payment under underlying contract is due. On the contrary, I consider that the correct contractual inference that should normally be drawn is that the beneficiary will be entitled to draw on the letter of credit provided that he has a bona fide claim to payment under the underlying contract. If this is correct, there is no

basis for the suggestion that the court should apply a different text when considering an application to restrain a beneficiary, rather than a bank, from effecting payment under a letter of credit.

As can be seen from the submission of counsel for the plaintiff, it was alleged that the first defendant was guilty of fraud/unconscionable conduct:

(i) by demanding on the bond when the first defendant was in breach;

(ii) the first defendant's non-disclosure of material facts to the second defendant, namely, that plaintiff had put an end to the contract by accepting the first defendant's repudiation, and that the plaintiff had alternatively, determined the contract pursuant to cl 26(i)(b) of the conditions of contract, thereby relieving the appellant from further performance of the contract; and

(iii) the first defendant is attempting to obtain payment of RM4.8m without going to arbitration or without adjudication by the court as to who is the innocent party and who is in breach of contract. This amounts to unjust enrichment and bad faith or unconscionable conduct on the part of the first defendant.

First of all we wish to point out that the authorities we have referred above clearly indicated that in order to justify any injunction to stop payment there must be clear evidence of fraud on the part of the first defendant which comes to the knowledge of the second defendant. Bad faith or unconscionable conduct by itself is not fraud. The examples given by the authorities above are those where from the very beginning there was intention to defraud the bank such as where the seller from the beginning had the intention not to send the goods to the buyer. That is not the case here. In the present case a genuine contract had been executed between the parties upon which the performance bond was given. From the record it is clear that works under the contract had commenced but then disputes between the parties arose and as a result of that the first defendant demanded payment under the performance bond.

With the greatest respect to the learned counsel for the plaintiff, not only fraud was not specifically pleaded but also it is clear to us the instances of fraud that he had stated in his submission are not instances of fraud but disputes between the parties. It is clear from the authorities those disputes must be settled between the parties and they would not affect the performance bond.

For that reason we hold that there was no evidence of fraud. What is more important is that the bank (second defendant) has no knowledge of any fraud or that fraud was ever given to their notice. As such the second defendant had no alternative but to honour the performance bond and meet the demand by the first defendant.

Fourth issue: Serious issues to be tried

Counsel for the plaintiff submitted injunction should be given to stop the payment by the second defendant (the bank) to the first defendant because

there are serious issues to be determined at an arbitration or in the court. According to the learned counsel the first defendant through its counsel in the court below had conceded in their submission that there are issues to be tried in the present appeal whether at a hearing in the court or at an arbitration. The plaintiff according to its counsel have an arguable case on the merits of the underlying dispute. Because of the concession, the plaintiff is entitled to the injunction to preserve the status quo, pending trial. Learned counsel for the plaintiff went on to submit that the issue whether the performance bond is a conditional or unconditional bond is in itself, a question to be tried, and therefore, there are also serious issues to be tried.

The answer to this contention is found in the statement of Phillips J in *Deutsche Ruckversicherung v Walbrook Insurance Co Ltd & Ors* where at p 1030 he said:

> I turn to consider Mr Bartlett's submission that a different test fails to be applied where an injunction is sought against the beneficiary. It seems to me that the effect of Mr Bartlett's submissions is to deprive the letter of credit of any special status so far as the beneficiary is concerned. If a beneficiary is to be held to be fraudulent if he draws on a letter of credit in circumstances where he is uncertain as to the validity of his right to payment under the underlying contract, the plaintiff seeking to enjoin him will have to do no more than persuade the court that there is a seriously arguable case that the claim under the underlying contract is invalid. *This will rob the beneficiary of much of the benefit which a letter of credit is intended to bestow. Where a letter of credit is issued by way of conditional payment under an underlying contract, I do not consider that it is correct to imply a term into the underlying contract that the beneficiary will not draw on the letter of credit unless payment under the underlying contract is due. On the contrary, I consider that the correct contractual inference that should normally be drawn is that the beneficiary will be entitled to draw on the letter of credit provided that he has a bona fide claim to payment under the underlying contract. If this is correct, there is no basis for the suggestion that the court should apply a different test when considering an application to restrain a beneficiary rather than a bank, from effecting payment under a letter of credit.* (Emphasis added.)

It is clear to us that since on demand performance bond is on similar footing as a letter of credit, serious issues to be tried is not one of the grounds upon which the court can grant an injunction against the beneficiary to stop payment from a bank under a performance bond. For that reason we see no merit in the submission of counsel for the plaintiff.

Fifth issue: Justice of the case

The final point raised by counsel for the plaintiff is justice of the case. It was submitted that the status quo ought to be maintained to preserve the subject matter and substratum of the suit pending the disposal of the suit in respect of the underlying contract either through trial or arbitration. Counsel for the plaintiff contended that if the injunction is not granted, the bank will make the payment which will alter the status quo, which will cause irreparable prejudice and damages to the plaintiff. It was further contended that any prejudice to the first defendant could easily be compensated by payment of interest.

In our view 'justice of the case' is what the first defendant called 'the balance of convenience test'. This principle was propounded in the *American Cyanamid* case. It was contended by the first defendant that the test is not applicable to an on demand performance bond. This was decided by the Court of Appeal in Singapore in *Bocotra Construction Pte Ltd v Attorney General (No 2)* [1995] 2 SLR 733 where it was held that the balance of convenience test propounded in the *American Cyanamid* case is not applicable to an irrevocable letter of credit. Since an on demand performance bond is of the same status as irrevocable letters of credit that case applies in the present appeal.

As submitted by counsel for the first defendant to which we agree, even if the *American Cyanamid* principle applied, the balance of convenience is still against the granting of injunction as pointed out in *Howe Richardson Scale Co Ltd v Polimex-Cekop and National Westminster Bank Ltd* [1978] 1 Lloyd's LR 161 where it was held by the Court of Appeal:

> The bank takes the view that the time has come and that it is compelled to pay; in my view it would be quite wrong for the court to interfere with Polimex's opponent right under this guarantee to seek payment from the bank, because to do so would involve putting upon the bank an obligation to inquire whether or not there had been timeous performance of the seller's obligations under the sale contract. Further, in accordance with the principles laid down by the House of Lords in the *American Cyanamid* case the balance of convenience, it seems to me, is against the grant of an injunction.

Conclusion

After considering the appeal as a whole we are of the view that the learned judge in the court below came to the right conclusion when he refused the injunction. We could not find any error in his decision. As correctly pointed out by both parties the granting of the injunction is a matter of discretion by the learned judge. The plaintiff had not shown to us that the learned judge had exercised his discretion wrongly or that the discretion exercised was illegal.

For the above reasons we would not disturb the decision of the learned judge. We therefore dismissed the appeal with costs and the decision of the learned judge in refusing the injunction is hereby affirmed.

The plaintiff applied for a stay of execution pending appeal to the Federal Court. This was made orally in court. We see no reason to stay the execution and we therefore dismissed the application.

Appeal dismissed.

Reported by Jafisah Jaafar